Office-Supreme Court, U.S.
FILED
APR 20 1981
ALEXANDER L. STEVAS,
CLERK

80-1754

No. ———

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

WEBSTER A. COLLINS, HERBERT R. MORRISON, HELEN O. MORRISON, AND GLEN A. WILKINSON,
Petitioners,

v.

DAVID R. JOHNSTON, THE NORTHWESTERN BANK, AND JAMES R. GILLEY,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

CALVIN H. COBB, JR.
(Counsel of Record)
STEPTOE & JOHNSON
1250 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 862-2000

T. WINFIELD BLACKWELL, JR.
JACK F. CANADY
BLACKWELL, BLACKWELL, CANADY & ELLER
2100 Wachovia Building
Winston-Salem, N.C. 27102
(919) 722-7161

HENRY A. MITCHELL, JR.
CARL N. PATTERSON, JR.
SMITH, ANDERSON, BLOUNT, DORSETT, MITCHELL & JERNIGAN
P.O. Box 31
Raleigh, N.C. 27602
(919) 821-1220

Attorneys for Petitioners

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTION PRESENTED

Whether a reorganization trustee may, in order to relieve the debtor's estate of claims by defrauded investors, cooperate with those investors by paying their costs in a joint lawsuit asserting related claims against the debtor's former management and others charged with defrauding the debtor and its investors.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
TABLE OF AUTHORITIES	iv
OPINIONS BELOW	1
JURISDICTIONAL STATEMENT	1
APPLICABLE STATUTES AND REGULATIONS	2
STATEMENT OF THE CASE	2
REASONS FOR GRANTING THE WRIT	8
I. THE DECISION OF THE COURT OF APPEALS RAISES AN IMPORTANT AND RECURRING QUESTION CONCERNING THE AUTHORITY OF THE TRUSTEE IN REORGANIZATION WHICH URGENTLY NEEDS RESOLUTION BY THIS COURT	8
II. REVIEW OF THE JUDGMENT BELOW IS REQUIRED TO RESOLVE THE CONFLICT BETWEEN CIRCUITS	18
CONCLUSION	20

PRECEDING PAGE WAS BLANK

TABLE OF AUTHORITIES

Cases	Page
American Employers' Insurance Co. v. *King Resources Co.*, 556 F.2d 471 (10th Cir. 1977)	13
In re Associated Gas & Electric Co., 149 F.2d 996 (2d Cir.), *cert. denied*, 326 U.S. 736 (1945)	13
Caplin v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972)	10, 14, 15, 16, 17
Carpenter v. *Hall*, 311 F. Supp. 1099 (S.D. Tex. 1970)	13
In re Credit Industrial Corp., 366 F.2d 402 (2d Cir. 1966)	13
Dietrich Corp. v. *King Resources Co.*, 583 F.2d 1143 (10th Cir. 1978)	13
Dorfman v. *First Boston Corp.*, Fed. Sec. L. Rep. (CCH) ¶ 94,155 (E.D. Pa. 1973)	13
In re Equity Funding Corp. of America, 519 F.2d 1274 (9th Cir. 1975)	12, 18
In re Equity Funding Corp. of America, 416 F. Supp. 132 (C.D. Cal. 1975)	12, 13, 17, 18
In re Farrington Manufacturing Co., 540 F.2d 653 (4th Cir. 1976)	13, 15
In re Four Seasons Nursing Centers of America, Inc., 472 F.2d 747 (10th Cir. 1973)	13
In re Four Seasons Nursing Centers of America, Inc., 357 F. Supp. 594 (W.D. Okla. 1973)	12, 18
Gilbert v. *Bagley*, 492 F. Supp. 714 (M.D.N.C. 1980)	14
Marrero v. *Abraham*, 473 F. Supp. 1271 (E.D. La. 1979)	16
McLean v. *Alexander*, 449 F. Supp. 1251 (D. Del. 1978), *rev'd on other grounds*, 599 F.2d 1190 (3d Cir. 1979)	16
Northwest Airlines, Inc. v. *Transport Workers Union*, 49 U.S.L.W. 3423 (U.S., argued Dec. 2, 1980) (No. 79-1056)	17
SEC v. *American Trailer Rentals Co.*, 379 U.S. 594 (1965)	8
SEC v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963)	8

TABLE OF AUTHORITIES—Continued

	Page
Wallenius Bremen G.m.b.H. v. *United States*, 409 F.2d 994 (4th Cir. 1969), *cert. denied*, 398 U.S. 958 (1970)	17
In re Washington Group, Inc., 476 F. Supp. 246 (M.D.N.C. 1979)	12, 15

Statutes and Regulations

Fed. R. Bankr. P. 801	8
Fed. R. Bankr. P. 10-208(a)	2, 3
Fed. R. Bankr. P. 10-801	8
11 U.S.C. § 47(a)(9) (1976)	12
11 U.S.C. § 64(a)(1)	12
11 U.S.C. § 110 (1976)	2, 10
11 U.S.C. § 541(a)-(b) (Supp. III 1979)	10
11 U.S.C. § 567(1), (3), (5), (6) (1976)	10
11 U.S.C. § 586 (1976)	2, 10
11 U.S.C. § 587 (1976)	2, 10
11 U.S.C. § 588 (1976)	10
11 U.S.C. § 589 (1976)	2, 10
11 U.S.C. § 1102 (Supp. III 1979)	9
11 U.S.C. § 1103 (Supp. III 1979)	9
11 U.S.C. § 1104 (Supp. III 1979)	9
11 U.S.C. § 1106 (Supp. III 1979)	10
11 U.S.C. § 1107 (Supp. III 1979)	10
11 U.S.C. § 1108 (Supp. III 1979)	10
11 U.S.C. § 1109(a) (Supp. III 1979)	9
11 U.S.C. § 1125 (Supp. III 1979)	9
11 U.S.C. prec. 101 note (Supp. III 1979)	3
28 U.S.C. § 1254(1) (1976)	2
28 U.S.C. § 1334 (1976)	8

Miscellaneous

Admin. Office of the U.S. Courts, Tables of Bankruptcy Statistics (1979)	12
Annual Report of the Director of the Administrative Office of the United States Courts (1979 & 1980 eds.)	12
4A Collier on Bankruptcy (14th ed. 1978)	10

TABLE OF AUTHORITIES—Continued

	Page
Fischer, *Contribution in 10b-5 Actions*, 33 Bus. Law. 1821 (1978)	16
Proposed Chandler Act: Hearings on H.R. 6439 before the House Comm. on the Judiciary, 75th Cong., 1st Sess. (1937)	9
H.R. Rep. No. 1409, 75th Cong., 1st Sess. (1937)	10
Restatement of Security (1941)	17
Restatement (Second) of Agency (1958)	17
SEC, Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees (1937-1940)	9

IN THE

Supreme Court of the United States

OCTOBER TERM 1980

No. ———

WEBSTER A. COLLINS, HERBERT R. MORRISON, HELEN O. MORRISON, AND GLEN A. WILKINSON,
Petitioners,

v.

DAVID R. JOHNSTON, THE NORTHWESTERN BANK, AND JAMES R. GILLEY,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Webster A. Collins, Herbert R. Morrison, Helen O. Morrison, and Glen A. Wilkinson respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

OPINIONS BELOW

The opinion of the district court is reported at 476 F. Supp. 246 (M.D.N.C. 1979). Appendix at 4a through 14a. The opinion of the United States Court of Appeals for the Fourth Circuit has not been reported. Appendix at 1a through 3a.

JURISDICTIONAL STATEMENT

The judgment of the United States Court of Appeals for the Fourth Circuit was entered on November 4, 1980. Appendix at 25a through 26a. A timely Petition for Re-

hearing and Rehearing En Banc was denied on January 19, 1981. Appendix at 27a through 28a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

APPLICABLE STATUTES AND REGULATIONS

Sections 70(a), 186, 187 and 189 of the Bankruptcy Act, 11 U.S.C. §§ 110(a), 586, 587 and 589 (1976), and Rule 10-208(a) of the Federal Rules of Bankruptcy Procedure are set forth in the Appendix at 29a through 33a.

STATEMENT OF THE CASE

Petitioners seek review of the decision of the court of appeals denying the Washington Group's reorganization trustee any power to cooperate with the company's defrauded investors by paying their costs in a joint lawsuit asserting overlapping claims[1] against the company's former management and others charged with defrauding the investors.[2] Despite the fact that the trustee's cooperation with the investors would have benefited the debt-

---

[1] As used herein, the phrase "overlapping claims" refers to claims that, although not identical, share common factual and legal bases and are asserted by the trustee and the defrauded investors.

[2] The bankruptcy court initially authorized the trustee to fund two companion civil actions related to the reorganization proceedings described herein. Gilbert v. Bagley, No. C-78-335-WS (M.D. N.C., filed July 26, 1978); Fulk v. Bagley, No. C-78-333-WS (M.D. N.C., filed July 26, 1978). Subsequently, the district court and the Fourth Circuit denied that authority. Joint appellants below, plaintiffs in both civil actions, were George W. Fulk, Thomas W. Shelton, William F. Suddeth, Webster A. Collins, Herbert R. Morrison, Helen O. Morrison, W. O. Gregory (who recently, by reason of illness, has requested leave of court to withdraw from that action, but continues to be a claimant in the reorganization proceedings), Glen A. Wilkinson and R. A. Gilbert, Trustee. Because there are special statutory and equitable considerations applicable solely to the employee claims asserted in *Fulk*, in which Fulk, Shelton and Suddeth are plaintiffs, a separate petition is being filed on behalf of those three persons.

ors' estate by relieving it of the investors' parallel claims [3] against the company, the lower court reversed the bankruptcy court's order authorizing the trustee's expenditures. Although this case involves the specific question of whether such expenditures are proper, it also raises the broader question of whether a reorganization trustee should be prohibited from taking economically prudent steps which any reasonable fiduciary would wish to take.

Reorganization proceedings involving The Washington Group, Inc. ("Washington Group" or "the company") and its subsidiaries (collectively "the debtors") were commenced in 1977.[4] Thereafter, the trustee in reorganization conducted the investigation required by Rule 10-208(a) of the Federal Rules of Bankruptcy Procedure [5] pertaining to the circumstances leading to the need for reorganization. The trustee then filed a Rule 10-208

---

[3] As used herein, the phrase "parallel claims" describes claims which are actionable against both the debtor in a reorganization proceeding and other defendants in a civil action; but for the pendency of the reorganization proceeding, the debtor could also be a defendant in such civil action. Successful prosecution of and recovery upon such claims in the civil action would discharge the debtor from any liability thereupon.

[4] Chapter X, together with the rest of the Bankruptcy Act, has been superseded by the Bankruptcy Reform Act of 1978, which revised and recodified the existing federal laws relating to liquidations and reorganizations of insolvent debtors. Pub. L. No. 95-598, 11 U.S.C. prec. 101 note (Supp. III 1979). Cases commenced prior to September 30, 1979, however, are to be "conducted and determined under [the Bankruptcy] Act as if [the Bankruptcy Reform] Act had not been enacted, and the substantive rights of parties in connection with any such bankruptcy case, matter, or proceeding shall continue to be governed by the law applicable . . . as if the [Bankruptcy Reform] Act had not been enacted." *Id.* There are, in any event, no significant differences between the Bankruptcy Act and the new Bankruptcy Code with respect to the issues in this case. Subsequent references to the Bankruptcy Act will be to the 1976 edition of the U.S. Code. References to the Bankruptcy Reform Act will be to Supp. III of the 1979 edition of the U.S. Code.

[5] Subsequent references to the Federal Rules of Bankruptcy Procedure will be as follows: "Rule ——."

report which documented the evidentiary support for numerous claims available to the debtors and to Washington Group investors arising from apparent mismanagement and fraud.

The trustee concluded that the debtors had substantial mismanagement claims against certain former officers, directors and other fiduciaries, including respondents Gilley and Johnston. Fourth Circuit Appendix at 66-69 ("Fourth Cir. App."). For example, in mid-1973 the Washington Group management entered into an employment contract with Johnston extending over an eighteen-year period and providing for total direct payments of $5,750,000, an amount which grossly exceeded the value of his actual or potential services to the company. *Id.* at 83-88. Another substantial claim identified by the trustee pertained to the company's gratuitous payment of the legal fees incurred by its co-defendants in the case of *Shaffner* v. *Washington Group, Inc.*, No. C-37-WS-73 (M.D.N.C., filed Jan. 23, 1973). In *Shaffner*, shareholders of the former Washington Mills Company, which was merged with a company controlled by respondent Gilley and Smith Bagley to form Washington Group, asserted that the merger had been effected by means of fraud and other unlawful acts. Fourth Cir. App. at 75-79. Although the company probably had no obligation to indemnify its co-defendants in *Shaffner*, it nevertheless assumed in settlement the entire burden of paying $709,000 in legal fees of all but one defendant. *Id.* at 102-04. The trustee's report leaves little doubt that the debtors' need for reorganization under Chapter X resulted from mismanagement and gross waste. *Id.* at 76-110.

The trustee's report also revealed that the facts supporting such claims of the trustee against various parties also supported substantial securities fraud claims by Washington Group investors against former management and others, and that such claims might also be made

against Washington Group in the reorganization proceedings on the theory of vicarious liability. Washington Group financial statements had chronically overstated the company's earnings by a total of $6,624,000 during the four-year period from 1973 to 1976, *id.* at 277-79; one substantial item that was improperly reported was the Johnston contract discussed above. *Id.* at 273-74, 277. Similarly, the trustee's findings as to the *Shaffner* case indicate that the *Shaffner* plaintiffs were fraudulently induced to enter into a settlement whereby minority shareholders were to be allowed to resell their shares to the company for $19 per share, and that the minority shareholders were thereafter fraudulently induced not to tender their shares. *Id.* at 82-83. Not only did Washington Group and its management issue materially false financial statements during the relevant period,[6] but management also manipulated the market price of Washington Group stock by, for example, stripping the debtors' employee benefit plans of such "blue chip" securities as IBM, Xerox and CBS in order to purchase common stock in the Washington Group, *id.* at 105-10,[7] pressuring employees to buy stock (while deterring any sales) and otherwise artificially increasing stock demand and reducing supply. In this fashion, management created a false picture of prosperity which could not help but mislead the investing public in general and the members of the *Shaffner* plaintiff class in particular. *Id.* at 82-83.

---

[6] Reported earnings for 1973 were $3,011,552, whereas the company actually suffered a *loss* of $1,450,176 during that year. Fourth Cir. App. at 24.

[7] The blue chip stocks were sold at a loss of nearly a half million dollars, whereas their subsequent appreciation and dividend payments would have totalled over $400,000 as of June, 1978. *Id.* at 107-08. In contrast, Washington Group stock, which was purchased for the plans at peak prices, is now all but worthless. *Id.* at 106-10.

As a result of these and other findings, and recognizing the potential for multi-million dollar claims against the estate, as well as the overlap in the trustee's and the investors' claims against the ultimate wrongdoers, the trustee applied for and received from the bankruptcy judge an order, dated July 25, 1978 and hereinafter cited as the July order, specifically authorizing the trustee to assert his claims against officers, directors and others identified in his report as wrongdoers and to join with and assist defrauded investors in prosecuting such an action.

In reliance on the July order and the trustee's report, the trustee and certain investors immediately filed a joint action styled *Gilbert* v. *Bagley*, No. C-78-335-WS (M.D.N.C., filed July 26, 1978) naming as defendants all of the respondents herein and others incriminated by the trustee's report. The trustee's *Gilbert* claims are asserted on behalf of the Chapter X estate, whereas the investors' *Gilbert* claims are asserted on behalf of themselves and a class of all similarly situated persons. Nevertheless, many of the investors' claims are based on the same facts as those of the trustee. Both the trustee and the investor plaintiffs allege that the defendants breached their fiduciary duties under North Carolina law. The investor plaintiffs assert in addition that failure to disclose the financial consequences of those breaches violated federal securities laws. In order to prove their overlapping claims in the *Gilbert* action, both the trustee and the investors will be required to set forth the significant features of the company's financial history from 1972 until the commencement of the reorganization proceedings in 1977.

Subsequent to joining the investor plaintiffs in bringing these and other claims in *Gilbert*, the trustee requested the bankruptcy judge to clarify the July order and to confirm that the trustee had authority to expend

the debtors' funds for costs, other than attorneys' fees, in *Gilbert*. In that request, the trustee observed that he and the plaintiff investors had relied on the July order in commencing *Gilbert*. Fourth Cir. App. at 297. He also indicated that the manipulations and mismanagement alleged in *Gilbert* and the companion action (*Fulk* v. *Bagley*) might give rise to claims against the estate in the Chapter X proceedings. *Id.* at 299. Citing the substantial factual and legal interrelationships among the trustee's claims in *Gilbert*, the investor plaintiffs' claims in *Gilbert*, and the employee plaintiffs' claims in *Fulk*, the trustee stated that

> it would be very difficult, if not impossible, to segregate that discovery and pretrial preparation that would be of benefit, for example, solely to your Applicant [the trustee] as opposed to the class action plaintiffs . . . . Discovery into these matters and the offer of proof at the trials will clearly involve a considerable overlap of facts and issues.

Fourth Cir. App. at 300. He concluded that "it would be in the best interest of the continued administration of these reorganization proceedings to assist in defraying the reasonable and necessary costs" of prosecuting *Gilbert*. *Id.* On January 16, 1979, the bankruptcy judge, finding the facts to be as stated by the trustee, issued an order ("the January order") granting the trustee's request. Thus, the trustee and the bankruptcy judge both concluded that assistance to the investor plaintiffs would serve the economic interests of the estate.

Respondents, who are also defendants in *Gilbert*, but participate in the Chapter X proceedings in their capacities as creditors and shareholders, challenged the January order on appeal.[8] On September 5, 1979, the district

---

[8] In the court below, petitioners unsuccessfully opposed respondents' appeal from the January order on timeliness grounds, but they do not seek certiorari as to that issue.

court [9] vacated the January order and directed the bankruptcy judge to deny the trustee authority to expend funds of the debtors to defray the investors' costs of prosecuting their related claims in the *Gilbert* action. Thereafter, the court of appeals adopted *per curiam* the district court opinion and denied a timely Petition for Rehearing and Rehearing En Banc.[10]

REASONS FOR GRANTING THE WRIT

I. THE DECISION OF THE COURT OF APPEALS RAISES AN IMPORTANT AND RECURRING QUESTION CONCERNING THE AUTHORITY OF THE TRUSTEE IN REORGANIZATION WHICH URGENTLY NEEDS RESOLUTION BY THIS COURT

The court below denied Washington Group's Chapter X trustee the authority to cooperate with the company's defrauded investors in the prosecution of their overlapping claims against former management and others charged with fraud. Such a holding contravenes this Court's mandate that legislation enacted for the purpose of protecting investors be construed flexibly so as to accomplish its remedial purposes. *See, e.g., SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963).

Congress' primary objective in enacting Chapter X was to insure adequate protection for public investors. *SEC*

---

[9] Jurisdiction of the district court was premised on 28 U.S.C. § 1334 and Rules 801 and 10-801.

[10] In the meantime, petitioners filed a proof of claims and other documents in the Chapter X proceedings seeking to preserve the rights of all defrauded investors to recover their losses from the debtors under the theory of vicarious liability. Although the bankruptcy judge has to date denied the petitioners any right to participate in the Chapter X proceedings, his order excluding their claims has been appealed to the district court not only by the petitioners but also by the SEC.

v. *American Trailer Rentals Co.*, 379 U.S. 594, 614 (1965).[11] A comprehensive study[12] relied upon in the formulation of Chapter X found investor-creditors of the debtor in reorganization unable, due to inadequate finances and inexperience, to protect their interests without assistance. SEC study, pt. II, at 1. Accordingly, the Commission recommended that in reorganization the "primary emphasis be given to the protection of the interests of investors." *Id.* pt. I, at 897. The importance of investor protection was reemphasized by the Commission in hearings on the bill which eventually became the Chandler Act:

> There is admittedly a widespread and national investor interest in these reorganization proceedings. . . . The holdings are small, and individual action by the security holders to protect themselves is, in many cases, out of the question. They either lack the funds, or the skill, the acumen or the initiative to take matters into their own hands. . . . The new system which is needed must afford not only a shield but a sword for bona-fide investors and their representatives . . . .

Proposed Chandler Act: Hearings on H.R. 6439 before the House Comm. on the Judiciary, 75th Cong., 1st Sess. 163 (1937).

---

[11] The protective features of Chapter X have been carried forward into the new Bankruptcy Code. *See* 11 U.S.C. §§ 1102-1103 (Supp. III 1979) (enabling committees representing investors to play a significant role in the reorganization proceedings); *id.* § 1104 (requiring appointment of examiner and/or trustee if such appointment is in the interest of any of the debtor's investors); *id.* § 1109(a) (allowing SEC to raise, appear and be heard on any issue arising in a reorganization case); *id.* § 1125 (requiring full written disclosure of all material information prior to soliciting acceptance of reorganization plan).

[12] SEC, Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees (1937-1940) ("SEC study").

The trustee is the "focal point" in the formulation and negotiation of a reorganization plan for the protection of public investors. H.R. Rep. No. 1409, 75th Cong., 1st Sess. 43-44 (1937).[13] Indeed, this Court in *Caplin* v. *Marine Midland Grace Trust Co.* recognized the trustee in reorganization as "the center of the statutory scheme." 406 U.S. 416, 423 (1972). It is the trustee who is best able to identify claims which inure directly or indirectly to the benefit of the estate, since he possesses all records of the debtor and conducts a thorough investigation of the debtor's affairs. 11 U.S.C. § 567 (1)-(3) (1976); *see* 11 U.S.C. § 1106(a)(3)-(4) (Supp. III 1979). He also occupies an advantageous position in identifying and evaluating claims *against* the estate. While the trustee is generally obligated to recognize such claims and to prepare a plan for payment thereof out of the estate's assets, 11 U.S.C. § 567(5)-(6) (1976); *see* 11 U.S.C. § 1106 (a)(2)-(5) (Supp. III 1979), parallel claims can be satisfied in a way that involves substantially less expense to the estate. When public investors have parallel claims, the trustee can most efficiently protect those investors, as well as maximize the eventual recovery for all creditors, by assisting the investors in prosecuting their parallel claims against former management and other wrong-

---

[13] The Chapter X trustee's manifold powers are set forth in 11 U.S.C. §§ 110, 586-589 (1976). These powers include the power to "operate the business and manage the property of the debtor," *id.* § 589, as well as any "powers which [the debtor] might have exercised for his own benefit, but not those which he might have exercised solely for some other person." *Id.* § 110(a); *see* 4A Collier on Bankruptcy ¶ 70.13[2], at 124 (14th ed. 1978). Under the new Bankruptcy Code, the reorganization trustee has substantially identical powers. *See* 11 U.S.C. §§ 541(a)-(b), 1106, 1108 (Supp. III 1979). In the absence of fraud, dishonesty, incompetence or gross mismanagement by current management, the debtor may remain in possession, and, if so, has the same powers as the trustee would have. *Id.* § 1107.

doers. Such litigation assistance thus not only serves the statutory goal of protecting public investors but also directly benefits the estate.

The primary benefit to the estate from such litigation assistance is, of course, enhancement of the availability of debtor assets for distribution to other creditors by eliminating parallel claims against the estate which would otherwise be prosecuted in the reorganization proceedings.[14] Successful prosecution of parallel claims also relieves the estate of the burden of prosecuting third-party claims for indemnification against the actual wrongdoers. Further, when, as in *Gilbert*, the trustee has overlapping claims which he asserts in a joint lawsuit, assistance rendered his co-plaintiffs will facilitate the prosecution of his claims by avoiding substantial duplication of discovery and proof. Cooperation between the trustee and the investor plaintiffs will result in substantial savings to the estate since, in exchange for bearing their comparatively minimal litigation costs, the trustee will benefit from the work of his co-plaintiffs' counsel in pursuing their clients' related claims. It is clear, then, that successful joint prosecution of parallel and overlapping claims facilitates both the negotiation and the ultimate success of the reorganization plan. The court below, in holding that the prosecution of the *Gilbert* action would not "direct[ly] benefit" the estate, did not disagree with the trustee's and the bankruptcy judge's assessment of the economic benefits to the estate, but rather deemed such benefits insufficient

---

[14] If the parallel claims were prosecuted in the reorganization, the trustee would incur both litigation costs and attorneys' fees, not to mention the possibility of ultimate liability on the claims. These expenditures would certainly exceed substantially the defrauded investors' *Gilbert* litigation costs, exclusive of attorneys' fees. Indeed, if the plaintiffs recover their litigation costs from the defendants in *Gilbert*, these sums will be restored to the estate.

to justify the expenditures merely because they were "indirect." *In re Washington Group, Inc.*, 476 F. Supp. 246, 252 (M.D.N.C. 1979).[15]

In view of the burgeoning number of reorganizations filed in recent years,[16] it is crucial that the Court define for both the reorganization trustee and potential investor plaintiffs the scope of the trustee's authority to cooperate with third parties in the prosecution of parallel and overlapping claims when successful prosecution thereof will eliminate claims against the estate. Such cooperation, which is of particular benefit to all except the wrongdoers, has been approved by various courts in a number of different forms, depending upon the circumstances of each case.[17] By obtaining authorization to cooperate with investors in the *Gilbert* action, the trustee sought to eliminate several million dollars in claims against the estate by defraying the comparatively minor out-of-pocket costs of litigating the related claims of his co-plaintiffs

---

[15] If the lower court intended to rule that a trustee may not expend estate resources to minimize outflow from the estate, but only to maximize income, it was clearly wrong as a matter of law. *See, e.g.*, 11 U.S.C. § 47(a)(9) (1976) (trustee must "examine all proofs of claim and object to the allowance of such claims as may be improper"); *id.* § 64(a)(1) (trustee may incur such expenses as are necessary to preserve the estate).

[16] A total of 3,975 reorganizations were filed in 1975. By contrast, during the 12-month period from October 1, 1979 to September 30, 1980, total filings numbered 5,745. Admin. Office of the U.S. Courts, Tables of Bankruptcy Statistics (1979); Annual Report of the Director of the Administrative Office of the U.S. Courts (1979 & 1980 eds.).

[17] *E.g.*, In re Equity Funding Corp. of Am., 519 F.2d 1274, 1276 (9th Cir. 1975) (litigation fund established by trustee pursuant to compromise); In re Equity Funding Corp. of Am., 416 F. Supp. 132, 154 (C.D. Cal. 1975) (litigation fund in reorganization plan); In re Four Seasons Nursing Centers of Am., Inc., 357 F. Supp. 594, 604 (W.D. Okla. 1973) (right to apply for loan to be used as litigation "war chest").

against management and other wrongdoers. The case provides but one illustration of the practical importance of trustee assistance in civil actions. Yet if the Fourth Circuit decision is allowed to stand, it will tie the hands of reorganization trustees by denying them the authority to cooperate, financially or otherwise, in the prosecution of related claims.

Similarly, if the lower court's decision is allowed to stand, it will pose a dilemma for all persons having claims which might be filed in a reorganization proceeding or against other parties, or claims which might be joined with a trustee's claim against others.[18] As a result of that decision, any such claimant who relies on the trustee's assistance in prosecuting a civil action risks the loss, not only of his civil action claims, but also of his claims in the reorganization proceedings.[19] On the other hand,

---

[18] The pressing need for resolution of the issue of the trustee's authority to assist in third-party civil actions is evidenced by the numerous cases in which reorganization claimants have had parallel claims. *See, e.g.*, Dietrich Corp. v. King Resources Co., 583 F.2d 1143 (10th Cir. 1978); American Employers' Ins. Co. v. King Resources Co., 556 F.2d 471 (10th Cir. 1977); In re Farrington Mfg. Co., 540 F.2d 653 (4th Cir. 1976); In re Four Seasons Nursing Centers of Am., Inc., 472 F.2d 747 (10th Cir. 1973); In re Credit Indus. Corp., 366 F.2d 402 (2d Cir. 1966); In re Associated Gas & Elec. Co., 149 F.2d 996 (2d Cir.), *cert. denied*, 326 U.S. 736 (1945); In re Equity Funding Corp. of Am., 416 F. Supp. 132 (C.D. Cal. 1975); Dorfman v. First Boston Corp., Fed. Sec. L. Rep. (CCH) ¶ 94,155 (E.D. Pa. 1973); Carpenter v. Hall, 311 F. Supp. 1099 (S.D. Tex. 1970).

[19] Petitioners herein, having relied on the trustee to defray the costs of the *Gilbert* action, are now in that unenviable position. The district court has indicated that the final decision as to the propriety of the trustee's commitment to fund the costs of the civil action may be dispositive as to class certification, because the plaintiffs' possible inability to defray these costs will render them,

if he should decline to cooperate with or to accept assistance from the trustee, he would be turning his back on a natural ally.

Most importantly, until this Court clarifies the scope of the trustee's authority, federal courts will be unable to streamline the complex litigation that inevitably arises when companies are forced into reorganization by the misdeeds of their management. Under the lower court's decision, overlapping and parallel claims would have to be prosecuted in different proceedings, first in the reorganization proceeding against the debtor and then in a separate action against the former management and others charged with such misdeeds. Moreover, the trustee must assert third-party claims for indemnity or contribution against the latter, which claims may well have to be litigated in yet a third action. In contrast, the litigation plan adopted by the trustee and defrauded investors herein contemplated complete resolution of all issues in a single civil action.

The specific question of a trustee's authority to fund joint civil actions has not yet been decided by this Court. Nevertheless, the lower court's opinion relied heavily and, it is respectfully submitted, incorrectly upon the opinion of this Court in *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), despite the fact that the "sole

---

in the district court's view, inadequate as class representatives. *See* Gilbert v. Bagley, 492 F. Supp. 714, 720 n.1 (M.D.N.C. 1980). Thus, recovery in the civil action may be foreclosed by the Fourth Circuit's decision. Ironically, petitioners' reliance upon the trustee's assistance in the civil action may also result in the forfeiture of their claims in the reorganization proceedings. The bankruptcy judge has ruled that the investor-creditors are not entitled to pursue their claims in the Chapter X proceedings because their acceptance of the trustee's assistance estops them from proceeding against him notwithstanding that the district court has withdrawn such assistance. As noted above, the bankruptcy judge's estoppel ruling is currently before the district court on appeal.

issue" presented in *Caplin* was whether the trustee had standing to sue a debenture trustee on behalf of persons holding debentures of the debtor. 406 U.S. at 416.[20] In a 5-4 decision, this Court held that the trustee lacked such standing. However, no question of trustee standing is presented here. As the lower court itself observed, *Washington Group* does not involve trustee standing, but rather " 'the appropriateness of litigation-related expenditures which may benefit the estate.' " *In re Washington Group, Inc.*, 476 F. Supp. 246, 251 (M.D.N.C. 1979). It nevertheless reasoned that the trustee should not be allowed "to do indirectly what *Caplin* forbids his doing directly." *Id.* at 252.[21]

This case provides the Court with an opportunity to determine whether *Caplin* should be read so broadly that it constitutes a strait jacket disabling the trustee from cooperating with investors having common litigation interests as well as potential claims against the estate. A decision by this Court clarifying the scope of *Caplin* would provide much needed guidance for future reorgani-

---

[20] *Caplin* denied standing for three reasons. First, the Court found no statutory basis for granting the trustee standing. 406 U.S. at 428-29. (No standing question is presented in the case at bar.) Second, the Court feared that the trustee's suit would be inconsistent with independent actions which might be brought by individual debenture holders. *Id.* at 431-34. (In *Gilbert*, the trustee's claims are closely related to, and not inconsistent with, the investors' overlapping claims.) Third, due to the doctrine of subrogation, recovery by the trustee in *Caplin* would not have benefited the estate, since to the extent that the debenture holders recovered against the debenture trustee, the debenture trustee would in turn be subrogated to their claims against the estate. *Id.* at 429-31. (There is no subrogation issue in the instant case since satisfaction of claims against former management and other actual wrongdoers would extinguish claims against the company.)

[21] In so finding, the court below ignored a prior Fourth Circuit decision mandating the award of fees and costs to a trustee's counsel for his assistance to defrauded investors in a related civil action. *See* In re Farrington Mfg. Co., 540 F.2d 653 (4th Cir. 1976).

zation trustees and claimants. *Caplin* itself provides some guidance as to the extent of a trustee's ability to assist independent civil class actions, but that guidance appears to conflict with the lower court's conclusion that the trustee must be prohibited from undertaking any such assistance. For instance, the *Caplin* Court suggested the initiation of class actions as a means of avoiding the trustee standing problem. Id. at 433.[22] Moreover, Mr. Justice Marshall recognized that, "[i]n enacting Chapter X, Congress had protection of public investors primarily in mind." 406 U.S. at 422. Yet the lower court's decision in this case would deny the trustee authority to pursue what is generally the most expedient and least costly method of protecting those investors: cooperation in the prosecution of related civil action claims. Furthermore, the *Caplin* majority emphasized the importance of reducing and simplifying litigation. 406 U.S. at 432. This goal would be frustrated if defrauded investors having parallel claims were forced to prosecute their claims in a reorganization proceeding and the trustee were thereafter compelled to pursue his resulting claims for indemnification or contribution in an independent action.[23] In con-

---

[22] A major factor underlying the Court's refusal to confer standing was its concern that the trustee was substituting his judgment for that of the debtor's debenture holders in bringing suit on their behalf, and that any such suit might conflict with independent actions brought by those same debenture holders. 406 U.S. at 431-32. No such danger exists where, as in the instant case, the trustee pursues only the claims of the debtors and assists his co-plaintiffs in prosecuting their claims, thereby eliminating parallel claims against the estate.

[23] Recovery by the investor plaintiffs of their claims against the estate in the reorganization proceedings would obligate the trustee to pursue the same defendants for indemnification or contribution. *See* Marrero v. Abraham, 473 F. Supp. 1271, 1275-78 (E.D. La. 1979); McLean v. Alexander, 449 F. Supp. 1251, 1266-67 & n.49 (D. Del. 1978), *rev'd on other grounds*, 599 F.2d 1190 (3d Cir. 1979). *See generally* Fischer, *Contribution in 10b-5 Actions*, 33 Bus. Law. 1821, 1823-27 & n.12 (1978). The uncertain state of the

trast, by embarking upon a sound litigation plan similar to the one adopted in this case, the trustee can reduce and simplify the litigation by consolidating all issues in a single civil action, pitting the defrauded investors directly against the former management and other actual tortfeasors without interposing the corporate entity first as a defendant under the doctrine of vicarious liability and then as a plaintiff under theories of contribution and/or indemnity.[24] Such a litigation plan would avoid circuity of action and at the same time speed resolution of the unencumbered reorganization proceedings, all clearly within the spirit of the *Caplin* decision.

---

law as to implied rights of contribution, *see, e.g.*, Northwest Airlines, Inc. v. Transcript Workers Union, 49 U.S.L.W. 3423 (U.S., argued Dec. 2, 1980) (No. 79-1056), argues even more forcefully in favor of allowing the trustee to act as he did in this case: If contribution were not available, the estate would risk liability for the *entire* amount of the investors' claims unless their civil action against former management and other wrongdoers were to succeed.

[24] Such a plan would not have eliminated claims against the estate or otherwise benefited the estate in *Caplin* because successful prosecution of the debenture trustee in the civil action would merely have enabled the debenture trustee to file identical claims in the Chapter X proceedings as subrogee of the debenture holders. 406 U.S. at 430-31. By contrast, if the plaintiffs are victorious in the *Gilbert* action, the defendants will not be subrogated to the investors' claims and thus cannot pursue those same claims against Washington Group in the reorganization proceedings. The doctrine of subrogation is inapplicable in *Gilbert* since any claims which the investors have against Washington Group are based solely on its vicarious liability for the acts of its agents. *Compare* Restatement of Security § 141 (1941) *with* Wallenius Bremen G.m.b.H. v. United States, 409 F.2d 994, 998 (4th Cir. 1969), *cert. denied*, 398 U.S. 958 (1970); Restatement (Second) of Agency § 439-440; *see also id.* §§ 401 & comment d, 438 & comment b (1958). Neither former management nor any of the other responsible parties would be entitled to seek indemnification or contribution from the company in the event that they were held liable to the investors in the civil action. In re Equity Funding Corp. of Am., 416 F. Supp. 132, 156 (C.D. Cal. 1975).

II. REVIEW OF THE JUDGMENT BELOW IS REQUIRED TO RESOLVE THE CONFLICT BETWEEN CIRCUITS

The Ninth Circuit has expressly authorized the trustee in reorganization to defray the cost of prosecuting parallel claims in related civil actions. *In re Equity Funding Corp. of America*, 519 F.2d 1274, 1276 (9th Cir. 1975). That same authority has now been denied by the Fourth Circuit. As a result of this conflict between the circuits, the right to rely on the assistance of a reorganization trustee is wholly dependent upon the fortuity of the location of the reorganization proceedings.

The Ninth Circuit in *Equity Funding* upheld then District Judge Pregerson's approval of the compromise of $314,000,000 in fraud claims in an Illinois liquidation proceeding against a subsidiary of the debtor in reorganization, whereby the sum of $1,250,000 in estate assets was allocated by the trustee to defray the costs of prosecuting claims in related civil litigation.[25] Quite properly, the court did not question the trustee's authority to provide financial assistance to the fraud claimants in the

---

[25] Various creditors and shareholders of the debtor, in addition to filing claims in the reorganization proceeding, had filed civil actions against the debtor's insolvent Illinois subsidiary, which was outside the jurisdiction of the bankruptcy court, and against certain fiduciaries of the debtor and its subsidiaries. All such actions were thereafter consolidated. The fact that allocation of estate assets to this civil litigation was effectuated in a state liquidation proceeding does not diminish its precedential value, since both the bankruptcy court and the Ninth Circuit approved such payment. Indeed, the fund was later supplemented by the transfer, pursuant to the reorganization plan, of $250,000 into the registry of the civil action court. In re Equity Funding Corp. of Am., 416 F. Supp. 132 (C.D. Cal. 1975). The sum, approved by Judge Pregerson, was to be used "for the benefit of the plaintiff classes as may be defined by the [civil action] Court, in such manner as said Court may order." *Id.* at 154. A similar provision was approved in In re Four Seasons Nursing Centers of Am., Inc., 357 F. Supp. 594, 604 (W.D. Okla. 1973).

related civil action. Rather, it focused on whether the trustee's decision to settle rather than litigate the fraud claims was reasonable under the circumstances.

The decision of the Fourth Circuit Court of Appeals in *Washington Group* is in direct conflict with that of the Ninth Circuit in *Equity Funding*. The Ninth Circuit permits the trustee in reorganization to defray the costs of a civil action to which he is not even a party. *A fortiori*, the trustee would be permitted to assist his co-plaintiffs in a joint civil action, where such assistance would benefit the estate not only by eliminating parallel claims but also by facilitating the prosecution of the trustee's claims. The Fourth Circuit, ignoring *Equity Funding*, denies the trustee such authority.

CONCLUSION

For the reasons set forth above, a writ of certiorari should issue to review the judgment of the Court of Appeals for the Fourth Circuit. Alternatively, if the Court grants the related petition in *Fulk* v. *Johnston* (*see* note 2 *supra*) without also granting this petition, petitioners respectfully suggest that the Court defer action on this petition pending resolution of the *Fulk* case.

Respectfully submitted,

CALVIN H. COBB, JR.
STEPTOE & JOHNSON
1250 Connecticut Avenue, N.W.
Washington, D.C. 20036

T. WINFIELD BLACKWELL, JR.
JACK F. CANADY
BLACKWELL, BLACKWELL, CANADY & ELLER
2100 Wachovia Building
Winston-Salem, N.C. 27102

HENRY A. MITCHELL, JR.
CARL N. PATTERSON, JR.
SMITH, ANDERSON, BLOUNT, DORSETT, MITCHELL & JERNIGAN
P.O. Box 31
Raleigh, N.C. 27602

Attorneys for Petitioners

April 1981

Appendices

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 79-1644

DAVID R. JOHNSTON; THE NORTHWESTERN BANK; JAMES R. GILLEY,

Appellees,

versus

R. A. GILBERT, Trustee,

Appellant,

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.;
CONVENIENT SYSTEMS, INC.;
WASHINGTON MILLS COMPANY;
JOHNSTON MILLS EXPORT COMPANY;
SPINNERS PROCESSING COMPANY;
WASHINGTON WEAVING COMPANY;
WASHINGTON MILLS SALES CORPORATION,

Debtors.

No. 79-1653

DAVID R. JOHNSTON; THE NORTHWESTERN BANK; JAMES R. GILLEY,

Appellees,

versus

GEORGE W. FULK, THOMAS W. SHELTON and WILLIAM F. SUDDETH,

Appellants,

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.;
CONVENIENT SYSTEMS, INC.;
WASHINGTON MILLS COMPANY;
JOHNSTON MILLS EXPORT COMPANY;
SPINNERS PROCESSING COMPANY;
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,

Debtors.

No. 79-1654

DAVID R. JOHNSTON; THE NORTHWESTERN BANK; JAMES R. GILLEY,

Appellees,

versus

WEBSTER A. COLLINS, HERBERT R. MORRISON, HELEN O. MORRISON, W. O. GREGORY, and GLEN A. WILKINSON,

Appellants,

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.;
CONVENIENT SYSTEMS, INC.;
WASHINGTON MILLS COMPANY;
JOHNSTON MILLS EXPORT COMPANY;
SPINNERS PROCESSING COMPANY;
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,

Debtors.

Appeal from the United States District Court for the Middle District of North Carolina, at Winston-Salem. Robert R. Merhige, Jr., District Judge

---

Argued October 6, 1980 Decided November 4, 1980

Before HAYNSWORTH, Chief Judge, BUTZNER and SPROUSE, Circuit Judges

---

O. William Faison; Calvin H. Cobb, Jr. and Howard H. Stahl (James D. Hutchinson, John D. Alkire, Peter L. Wellington, Steptoe & Johnson; C. Edwin Allman, R. Bradford Leggett, Hatfield & Allman; T. Winfield

Blackwell, Jr., Jack F. Canady, Jack E. Thornton, Jr., Blackwell, Blackwell, Canady & Eller; Henry A. Mitchell, Jr., Carl Patterson, Smith, Anderson, Blount, Dorsett, Mitchell and Jernigan on brief) for Appellants; W. Donald Carroll, Jr. (Jonathan E. Buchan, Helms, Mulliss & Johnston on brief); John H. Northey, III (Caudle, Underwood & Kinsey on brief); Roy G. Hall, Jr. (Hall and Liner on brief) for Appellees.

PER CURIAM:

The trustee in a Chapter X bankruptcy proceeding and past and present shareholders and employees of the debtor corporations appeal a district court judgment vacating two orders entered by the bankruptcy judge. These orders authorized the trustee to expend funds from the debtors' estate to defray the costs of two class action suits brought by employees, shareholders and, in one case, the trustee as a co-plaintiff against former officers, directors and fiduciaries of the debtors. The appellants primarily contend that the district court erred in holding that the trustee was not entitled to use funds in this manner. The parties also raise a number of threshold and procedural issues, including the correctness of the district court's ruling that the time to appeal the bankruptcy judge's orders should have been extended on grounds of excusable neglect.

We affirm for reasons sufficiently stated by the district judge in his opinion. *In re Washington Group, Inc.*, 476 F. Supp. 246 (M.D.N.C. 1979). We also find that those issues not governed by the opinion below do not compel a contrary result, and merit no further discussion.

Affirmed.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF
NORTH CAROLINA
Winston-Salem Division

In Chapter X
Reorganization Numbers

B-77-695	B-77-696
B-77-697	B-77-698
B-77-699	B-77-700
B-77-701	B-77-702

[Filed Sept. 5, 1979]

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.,
CONVENIENT SYSTEMS, INC.,
WASHINGTON MILLS COMPANY,
JOHNSTON MILLS COMPANY,
JOHNSTON MILLS EXPORT COMPANY,
SPINNERS PROCESSING COMPANY,
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,

Debtors.

MEMORANDUM

This matter is before the Court on appeal from an order of the Bankruptcy Court. The following two issues are presented: (1) whether in the circumstances of this case the Bankruptcy Judge erred in denying appellants an extension of time within which to file their appeal to this Court, and (2) whether the Bankruptcy Judge erred in allowing the Trustee in Bankruptcy to expend funds of the Debtors' estate to assist in defraying the costs of two potentially massive civil suits, in only one of which

the Trustee is a named plaintiff, against former officers, directors, and fiduciaries of the Debtors. The three appellants, David R. Johnston, James R. Gilley, and the Northwestern Bank, are creditors and shareholders of the bankrupt companies. Jurisdiction is proper under Bankruptcy Rule 801 and 28 U.S.C. § 1334.

On June 20, 1977, Chapter X reorganization proceedings commenced with respect to the Washington Group, Inc. and its subsidiaries. R. A. Gilbert was appointed Trustee in Bankruptcy, and he immediately began his investigation and operation of the bankrupt corporations. He filed his report to the Bankruptcy Court on June 30, 1978, and in that report he included facts pertaining to potential causes of action available to the estate.

On July 21, 1978 and July 25, 1978, respectively, the Bankruptcy Judge entered orders that (1) authorized the Trustee to assist employees of the Debtors in securing compensation for losses occasioned by mismanagement of employee benefit plans, and (2) authorized the Trustee to sue on behalf of the estate and to join with any other plaintiffs in such action. On July 25, 1978, two civil class actions suits relating to the affairs of the Debtors were filed in this court. *Gilbert* v. *Bagley*, C-78-335-WS, and *Fulk* v. *Bagley*, C-78-333-WS. *Gilbert* involves claims by the Trustee, on behalf of the Debtors, asserting waste, mismanagement, and breach of fiduciary duties by officers, directors, and other fiduciaries of the Debtors. Additionally, *Gilbert* includes claims by certain representative shareholders of the Debtor, The Washington Group, Inc., on behalf of a proposed class of such shareholders, based on alleged securities law fraud and related misconduct, as well as unlawful conduct during the pendency and settlement of an earlier shareholders' action. In *Fulk*, certain representative employees of the Debtors, on behalf of a proposed class of such employees, have asserted federal and common law claims arising

out of abuses in the management of the debtor corporations' various employee benefit plans by directors, officers, and other fiduciaries of the Debtors. The Trustee is not a party in *Fulk*. Discovery relative to class certification issues has been completed in both actions. General discovery, however, has been stayed pending resolution of a criminal action against certain of the named defendants.

On January 15, 1979, the Trustee filed an Application with the Bankruptcy Court seeking express authority to expend the funds of the Debtors for costs, other than attorneys' fees, in the *Gilbert* and *Fulk* actions, asserting that "it would be in the best interest of the continued administration of these reorganization proceedings to assist in defraying the reasonable and necessary costs of maintaining" the *Fulk* and *Gilbert* actions. No notice was given to the Debtors' creditors or stockholders. In an order dated January 16, 1979, without the benefit of any hearing, the Bankruptcy Judge granted the Application. That order stated in pertinent part:

> Upon the annexed Application of R. A. Gilbert, Trustee of the above-named Debtors, the Court having determined that said Application was one which might be heard *ex parte* and the Court having found as facts the matters stated in said Application; and for sufficient reasons appearing and good cause shown, it is
>
> ORDERED, ADJUDGED AND DECREED that the Trustee be and he is hereby authorized to use the funds of the Debtors to assist in defraying the reasonable and necessary costs of maintaining the two class actions known and designated as *Gilbert, et al.* v. *Bagley, et al.* and *Fulk, et al.* v. *Bagley, et al.*, which class actions are presently pending in the United States District Court for the Middle

> District of North Carolina, save and except payment of professional fees of the attorneys for the class action plaintiffs.

The Clerk did not, nor was he directed to, send copies or other notice of this order to counsel for any of the creditors herein.

The ten day period within which to appeal this order expired on January 26, 1979. On February 9, 1979, David R. Johnston and the Northwestern Bank both filed Notices of Appeal from the January 16, 1979 order. On the same date, Johnston and Northwestern requested pursuant to Bankruptcy Rule 802(c) that the Bankruptcy Judge retroactively extend the ten-day period. On February 12, 1979, James R. Gilley filed his Notice of Appeal from the January 16, 1979 order, but did not request a retroactive extension of time. At a hearing on February 27, 1979, the Bankruptcy Judge denied the motions of Northwestern and Johnston for a retroactive extension of time in which to appeal. An order to that effect was entered on March 12, 1979. Northwestern filed a Notice of Appeal from the March 12, 1979 order on March 21, 1979, together with a Designation of Record on Appeal and Statement of Issues. On March 23, 1979 Johnston filed a Notice of Appeal of the March 12, 1979 order, together with his Designation of Record on Appeal and Statement of Issues.

On appeal before this Court, therefore, are the two orders of the Bankruptcy Judge entered on March 12, 1979 and January 16, 1979, respectively. Consideration of the earlier dated order is dependent upon a reversal of the later order.

Any analysis of these questions must be predicated upon an understanding of the overall context of and relationship between the bankruptcy proceedings and the pending civil actions. The three appellants in this

action, James R. Gilley, David R. Johnston, and the Northwestern Bank, are all defendants in *Gilbert*, and appellants Gilley and Northwestern are defendants in *Fulk*. Appellants Johnston and Northwestern, however, are also creditors of the bankrupt Debtors, and it is in this capacity that they are seeking to reverse the order of January 16, 1979 authorizing expenditure of the estate's funds to support the *Gilbert* and *Fulk* actions. Appellant Gilley is the majority shareholder of the Washington Group, and he is similarly interested in preventing improper use of the Debtor's limited resources. Therefore, while these appellants all may legitimately attack an order the effect of which will be dilution of the bankrupts' monies, the Court cannot help but be aware that success on the issues now pending will redound to appellants' benefit in their capacities as defendants in the civil actions.[1]

The threshold inquiry is whether the Bankruptcy Judge was mistaken in denying appellants' motion for a retroaction extension of the ten day appeal period. Bankruptcy Rule 802(c) requires that requests for extensions be made within the ten day period, "except that a request made after the expiration of such time may be granted upon a showing of excusable neglect." As the District Court for the Southern District of New York has noted:

> The question of excusable neglect is left to the discretion of the Bankruptcy Court Judge whose decision should not be set aside unless the 'reviewing

---

[1] It is interesting to note that appellant Johnston apparently is a defendant in *Gilbert* because the Washington Group bought out his family's closely held textile company and he remained on as an employee. The complaint in *Gilbert* does not allege that Johnston was an officer or director of the Washington Group, but he admits to being a stockholder, leading the Court to wonder whether he ought not to be a plaintiff rather than a defendant. This question of course is not before the Court, and the Court expresses no opinion relative thereto.

> court has a definite and firm conviction that the court below committed a clear error of judgment ....'

In re Gurda, 19 Collier Bankruptcy Cases 568, 569 (S.D.N.Y. 1979) (footnote omitted). For the reasons that follow, the Court has concluded that the Bankruptcy Court's order of March 12, 1979 was clearly erroneous.

Notions of fundamental fairness impel a reviewing court to look closely at actions taken ex parte. This is especially so where a Trustee in Bankruptcy is asking for approval of what could be substantial expenditure of the Debtors' funds. Creditors and shareholders of the bankrupt estates have an absolutely legitimate interest in monitoring the manner in which the estate's resources are spent, and the Trustee, as their legal representative, owes them a duty to keep them informed of his activities. *See* Bankruptcy Rule 10-209. That the instant appellants also happen to be defendants in the *Bagley* and *Fulk* actions does not in any way limit their right, as creditors and shareholders, to be informed of, and in appropriate circumstances, to participate in, important actions taken by the Trustee. The Court therefore cannot help but look initially with suspicion upon the actions taken in this matter by both the Trustee and the Bankruptcy Court.

Appellants have not cited, nor has the Court in its research discovered, either a case or Bankruptcy Rule precisely on point. Other than the broad principles enunciated above, drawn from the general spirit of the bankruptcy process, Bankruptcy Rule 10-209(b)(6) seems to be the most nearly applicable provision. It provides that the Trustees shall give all creditors and stockholders at least twenty days notice of "the hearing on applications for . . . reimbursements of expenses." *See also* Rule 10-216. Here, of course, the Trustee was not seeking reimbursement of expenses; rather, he was asking for a blank check with which to draw an undetermined, but

clearly substantial, amount from the funds of the Debtors. The Court cannot imagine a clearer instance, not explicitly covered by the Rules, in which notice to creditors and shareholders would be appropriate.

Rule 922(a) requires the Bankruptcy Court to mail notice of orders entered to any party who opposed the entry of the order. No such notice was mailed with regard to the January 16 order. The Trustee argues, however, that notice was not required because no one opposed his application. Though this may be technically correct, the Court will not penalize appellants for their failure to oppose an application submitted without notice to them and decided without giving them an opportunity to be heard.

The Trustee also argues that the January 16 order merely confirmed the authority already granted him by the Bankruptcy Court in its orders of July 11 and 25, 1978, and that, because appellants did not appeal those orders, they should not now be allowed to appeal the January 16 order. Suffice it to say that, had the July orders actually granted the Trustee the authority to use the Debtors' funds to help support the *Gilbert* and *Fulk* actions, the Court is at a loss to understand why the Trustee felt it incumbent to make further application to the Bankruptcy Court.

Appellants and the Trustee agree that appellants did not learn of the January 16 order until January 31. They further agree that appellants Johnston and Northwestern filed their notices of appeal nine days later. The tenth day, February 10, was a Saturday, and appellant Gilley filed his notice of appeal on Monday, February 12. This delay, with the attendant circumstances already discussed, quite clearly falls within the "excusable neglect" exception to the Rule 802(a) requirement that notices of appeal be filed within ten days. As the United States Court of Appeals for the Fourth Circuit has noted

in a related context: "Failure to learn of the entry of judgment is the principal ground on which extensions of time for appeal are granted." *Babich* v. *Clower*, 528 F.2d 293, 295 (4th Cir. 1975). Accordingly, the March 12, 1979 order of the Bankruptcy Court denying appellants Johnston's and Northwestern's motions for extensions of time within which to appeal the order of January 16, 1979 will be vacated, and the Bankruptcy Court will be directed to grant the motions. Because the Bankruptcy Court should have allowed appellants to file notices of appeal regarding the order of January 16, the Court will now consider the appropriateness of that order.

As a general proposition, it is beyond dispute that the Trustee's duty is to act in the best interests of the Debtors' estate. Protection of the rights and interests of creditors and shareholders, with which the Trustee is charged, depends largely upon the success of the Trustee in managing the estate, and his actions must be calculated to bring *direct* benefit to the estate. There is of course no question regarding the Trustee's authority to sue on behalf of the estate. Expenditure of the estate's funds in this regard is entirely proper, for success by the Trustee in *Gilbert* will accrue directly to the benefit of the estate. Of concern to appellants, however, is use of the estate's resources to help prosecute actions by the shareholder plaintiffs in *Gilbert* and all the plaintiffs in *Fulk*. Should these plaintiffs prevail, not one dime of their recovery will go into the treasury of the Debtors' estate.

The Trustee asserts that expenditure of the estate's funds to help support the *Gilbert* action may be justified on three grounds:

> (a) recovery by plaintiff stockholders in *Gilbert* would eliminate claims which might otherwise be made in the reorganization proceeding . . . ; (b) the close interrelationship of the claims of the

> Trustee . . . and the shareholder plaintiffs . . . clearly indicates that a strong and vigorous prosecution of the shareholders' claims through discovery and into trial would prove to be a material benefit to the discovery and proof of evidence to support the Trustee's claims; [and] (c) proof of matters which support the basis for the claims of the plaintiff shareholders against the defendants, insofar as these claims are distinct from the Trustee's action, could . . . expedite and facilitate the objection to claims which have been filed by certain of the defendants in the reorganization proceedings.

With respect to *Fulk*, the Trustee argues that "[p]ension-related claims are entitled to special consideration in a reorganization proceeding and may even be entitled to treatment as a first priority administrative expense." He further notes that the Trustee is charged with attempting to continue operation of the Debtors' estate, and that this duty cannot be fulfilled without boosting and maintaining the morale of the employees—a task made much easier if compensation owed from employee benefit plans is paid to the employees.

Notwithstanding the apparent logic of the Trustee's arguments, his authority is strictly prescribed by the Bankruptcy Act. Congress might well have decided to grant the Trustee broad license either to sue on behalf of or provide financial assistance to third parties with claims against the estate. The Court has concluded, however, that the Bankruptcy Act contemplates a narrower range of options for the Trustee. He may only bring actions and expend funds on behalf of the estate. If he is successful, his duty is then to apportion, in accordance with the provisions of the Act, whatever recovery he reaps among the various parties with claims against the estate. Claimants of course include creditors, shareholders, and in this case employees. The high priority afforded pension-related claims does not mean the Trustee

may expend funds of the estate to support a class action suit by employees, as meritorious as it may appear. It means instead that, when the time comes to attempt to satisfy the obligations of the Debtors, employees thereof are entitled to stand near the front of the line. That shareholders and employees will no doubt have claims against the estate does not justify the Trustee's reaching into the estate's coffers to help them sue former officers, directors, and fiduciaries of the estate. The shareholders and employees' causes of action against these defendants are independent from whatever claims they may also wish to pursue against the estate.

The leading case in this area, cited and relied upon by both the Trustee and the appellants, is *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972). As the Trustee notes in his brief, *Caplin* is a decision regarding a "Trustee's standing to sue, not . . . the appropriateness of litigation-related expenditures which may benefit the estate." That the Supreme Court did not have occasion to address this latter issue does not prevent this Court from applying to the instant case the principles on which *Caplin* rests.

Caplin involved a suit brought by a Chapter X Trustee, on behalf of those persons owning debentures issued by the bankrupt company, against the indenture trustee for breach of its duty owed to the debenture holders. The Trustee in *Caplin* argued, among other things, that it was in a "better position than debt investors to discover and to prosecute claims based on the alleged failure of an indenture trustee to live up to the provision of the indenture." *Id.* at 427. The Court disagreed, noting that "Congress has established an elaborate system of controls with respect to indenture trustees and reorganization proceedings, and nowhere in the statutory scheme is there any suggestion that the trustee in reorganization is to assume the responsibility of suing third parties on behalf of debenture holders." *Id.* at 428. Then, in a

passage critical to the instant case, the Court referred to 11 U.S.C. § 567(3), which is the pivotal provision of the Bankruptcy Act prescribing the powers and duties of the Trustee, and asserted that "there is nothing in the section that enables [the Trustee] to collect money not owed to the estate." *Id.* The rationale of the Court's holding in *Caplin* is unmistakable. The Trustee may only act for the direct benefit of the estate. In asking this Court to limit *Caplin* to cases where the Trustee actually is suing on behalf of some third party claimant, as opposed to cases where the Trustee is merely footing the bill, the Trustee is requesting the Court to allow him to do indirectly what *Caplin* forbids his doing directly.[2]

For the foregoing reasons, the Court has concluded that the Bankruptcy Court's order of January 16, 1979 must be vacated, and the Trustee's application of January 15, 1979 must be denied to the extent it sought authority to use the funds of the estate to help support claims other than that brought by the Trustee.

An appropriate order shall issue.

/s/ Robert R. Merhige
United States District Judge

---

[2] At least two other courts have applied this rationale. In *Rochelle* v. *Marine Midland Grace Trust Co.*, 535 F.2d 523, 527 (9th Cir. 1976), Judge Hufstedler cited *Caplin* in summarily affirming the district court's dismissal of a suit brought by the Trustee on behalf of the Debtor's creditors and debenture purchasers: "[A] reorganization trustee has no standing to maintain the action on the part of any person or entity other than his debtor corporation." Similarly, in *King* v. *Sharp*, 63 F.R.D. 60, 63 (N.D. Tex. 1974), the Court noted that: "Congress has not seen fit to endow a Chapter X Trustee with the freedom to champion causes that will produce benefits to third parties. If the bankrupt estate has no cause of action in its own right, then the Trustee has no authority to institute suits as a class representative or otherwise for the benefit of third parties."

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF
NORTH CAROLINA
Winston-Salem Division

In Chapter X
Reorganization Numbers

B-77-695	B-77-696
B-77-697	B-77-698
B-77-699	B-77-700
B-77-701	B-77-702

[Filed Sept. 5, 1979]

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.,
CONVENIENT SYSTEMS, INC.,
WASHINGTON MILLS COMPANY,
JOHNSTON MILLS COMPANY,
JOHNSTON MILLS EXPORT COMPANY,
SPINNERS PROCESSING COMPANY,
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,
Debtors.

ORDER

For the reasons stated in the memorandum of the Court this day filed, and deeming it proper so to do, it is ADJUDGED and ORDERED as follows:

1. The orders of the Bankruptcy Court dated March 12, 1979 and January 16, 1979 are hereby vacated; and

2. The Bankruptcy Court is directed (a) to enter an order granting appellants' request for a retroactive extension of time within which to file their Notices of

Appeal, and (b) to enter an order denying the Trustee's application of January 15, 1979 requesting authority to utilize funds of the Debtors to defray the costs of prosecuting *Gilbert, et al.* v. *Bagley, et al.*, No. C-78-335-WS, and *Fulk, et al.* v. *Bagley, et al.*, No. C-78-333-WS, except that the Trustee may utilize the Debtor's fund to prosecute that portion of the *Gilbert* action in which the Trustee is suing on behalf of the Debtors' estate:

Let the Clerk send copies of the memorandum and this order to all counsel of record.

/s/ Robert Merhige
ROBERT MERHIGE
United States District Judge

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF
NORTH CAROLINA

In Chapter X
Reorganization Numbers

B-77-695, B-77-696,
B-77-697, B-77-698,
B-77-699, B-77-700,
B-77-701, B-77-702

[Filed: July 25, 1979]

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.,
CONVENIENT SYSTEMS, INC.,
WASHINGTON MILLS COMPANY,
JOHNSTON MILLS COMPANY,
JOHNSTON MILLS EXPORT COMPANY,
SPINNERS PROCESSING COMPANY,
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,
Debtors.

ORDER GRANTING AUTHORITY TO PROSECUTE LEGAL ACTIONS BASED ON FRAUD, MISCONDUCT, IRREGULARITIES, OR MISMANAGEMENT OF THE DEBTOR CORPORATIONS

At Greensboro, in said district, on the 25th day of July, 1978.

Upon the annexed Application of the Trustee for the above-named Debtors, the Court having found the facts to be as stated therein, and for good cause shown; it is

ORDERED that R. A. Gilbert, Trustee, be, and he is hereby, granted permission and authority to take whatever action is deemed appropriate to assert claims or causes of action based on fraud, misconduct, irregularities, or mismanagement of the Debtor corporations against any and all corporations, entities or individuals who might be deemed liable for such acts, and, if the Trustee deems it appropriate, that he be, and he is hereby, granted authorization to join with other plaintiffs in the prosecution of such claims or causes of action.

/s/ Rufus W. Reynolds
RUFUS W. REYNOLDS
Bankruptcy Judge

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT
OF NORTH CAROLINA

In Chapter X Reorganization Numbers

B-77-695, B-77-696,
B-77-697, B-77-698,
B-77-699, B-77-700,
B-77-701, and B-77-702.

[Filed Jan. 15, 1979]

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.,
CONVENIENT SYSTEMS, INC.,
WASHINGTON MILLS COMPANY,
JOHNSTON MILLS COMPANY,
JOHNSTON MILLS EXPORT COMPANY,
SPINNERS PROCESSING COMPANY,
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,
Debtors.

ORDER AUTHORIZING EXPENDITURE OF FUNDS FOR COSTS IN PLENARY CLASS ACTIONS

At Greensboro, N. C., in said District, this 16th day of January, 1979.

Upon the annexed Application of R. A. Gilbert, Trustee of the above named Debtors, the Court having determined that said Application was one which might be heard *ex parte* and the Court having found as facts the matters stated in said Application; and for sufficient reasons appearing and good cause shown, it is

ORDERED, ADJUDGED AND DECREED that the Trustee be and he is hereby authorized to use the funds of the Debtors to assist in defraying the reasonable and necessary costs of maintaining the two class actions known and designated as *Gilbert, et al.* v. *Bagley, et al.* and *Fulk, et al.* v. *Bagley, et al.*, which class actions are presently pending in the United States District Court for the Middle District of North Carolina, save and except payment of professional fees of the attorneys for the class action plaintiffs.

/s/ Rufus W. Reynolds
RUFUS W. REYNOLDS
Bankruptcy Judge

APPENDIX F

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT
OF NORTH CAROLINA

In Chapter X Reorganization Numbers

B-77-695, B-77-696,
B-77-697, B-77-698,
B-77-699, B-77-700,
B-77-701, and B-77-702.

[Filed Mar. 12, 1979]

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.,
CONVENIENT SYSTEMS, INC.,
WASHINGTON MILLS COMPANY,
JOHNSTON MILLS COMPANY,
JOHNSTON MILLS EXPORT COMPANY,
SPINNERS PROCESSING COMPANY,
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,
Debtors.

ORDER DENYING MOTIONS FOR EXTENSION OF TIME IN WHICH TO FILE NOTICE OF APPEAL

At Greensboro, in said district, on the 12th day of March, 1979.

This matter coming on for hearing and being heard on the motions of The Northwestern Bank and David R. Johnston seeking an extension of time in which to file notice of appeal of an order entered by this Court on January 16, 1979, and the Court finding that said motions were not filed within ten days following the date of entry of said order; and the Court having concluded

that it does not have authority under the provisions of Rule 802(c) and Rule 10-801, Rules of Bankruptcy Procedure, to extend the time for filing notice of appeal once the initial ten-day period has expired; and the Court further concluding that if it did have such authority, in the exercise of its discretion it would deny the motions for extension of time in which to file notice of appeal; it is

ORDERED that the motions filed on behalf of The Northwestern Bank and David R. Johnston on February 9, 1979 seeking an extension of time for filing their notices of appeal be, and the same hereby are, denied, and since this Court has concluded it is without authority to act, such denial is without prejudice to The Northwestern Bank and David R. Johnston to renew and present these same motions to the United States District Judge.

/s/ Rufus W. Reynolds
RUFUS W. REYNOLDS
Bankruptcy Judge

APPENDIX G

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 79-1644

DAVID R. JOHNSTON; THE NORTHWESTERN BANK; *et al.*,
Appellees

v.

R. A. GILBERT, TRUSTEE,
Appellant

No. 79-1653

DAVID R. JOHNSTON; THE NORTHWESTERN BANK; *et al.*,
Appellees

v.

GEORGE W. FULK, *et al.*,
Appellants

No. 79-1654

DAVID R. JOHNSTON; THE NORTHWESTERN BANK; *et al.*,
Appellees

v.

WEBSTER A. COLLINS, *et al.*,
Appellants

ORDER

On September 5, 1979 the district court reversed a January 16, 1979 order of the bankruptcy court authorizing the expenditure of funds and costs in two class actions, the short styles of which are *Gilbert* v. *Bagley*, No. C-78-335-WS (M.D. N.C.), and *Fulk* v. *Bagley*, No. C-78-333-WS (MD NC) [sic]. The expenditure of funds

and costs was to be used by the trustee to aid and assist in the prosecution of said civil suits on behalf of the bankrupt estate, which had been authorized by order dated July 21, 1978.

Later, by opinion dated May 15, 1980, the bankruptcy court, in an opinion in another but related matter, indicated that its initial authority to proceed with the *Gilbert* and *Fulk* civil actions in the Middle District of North Carolina, and the expenditure of funds for that purpose, had been a mistake. Nevertheless, orders of the bankruptcy court, above mentioned, of July 21, 1978 and January 15, 1979, are yet extant, and, so far as we are advised, are unmodified except by the order of the district court of September 5, 1979, above mentioned, which is the order appealed from.

No reason has been brought to our attention why the orders of the bankruptcy court authorizing the trustee to proceed with the *Gilbert* and *Fulk* cases, and authorizing the expenditure of funds on that account, could not be later revoked by the bankruptcy court. If that were done, the instant appeal might well be moot. But the orders of the bankruptcy court of July 21, 1978 and January 16, 1979 are yet in full force and virtue but for the order of the district court appealed from.

We are thus of opinion the case is not now moot, and it is accordingly ADJUDGED and ORDERED that the motion to dismiss the appeal on account of mootness shall be, and the same hereby is, denied.

With the concurrences of Judge Haynsworth and Judge Hall.

/s/ H. Emory Widener
For the Court

APPENDIX H

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

November 04, 1980

TO:

Henry C. Ikenberry, Esq.
James D. Hutchinson, Esq.
Howard H. Stahl, Esq.
Laura Stone, Esq.
Charles G. Cole, Esq.

T. Winfield Blackwell, Esq.
Jack F. Canady, Esq.

Roy G. Hall, Esq.

W. Donald Carroll, Esq.

John H. Northey, Esq.
Lloyd Caudle, Esq.

NOTICE OF JUDGMENT

Judgment was entered in Case No. 79-1653 this date. The Court's opinion is enclosed.

Petition for Rehearing (FRAP 40)

Filing Time

A petition may be filed within 14 days after judgment. *No extensions will be granted save for the most compelling reasons.* Requests based on grounds such as miscalculation of time or a need to consult with others will be peremptorily denied.

Purpose

A petition should only be made to direct the Court's attention to one or more of the following situations:

1. A material fact or law overlooked in the decision.
2. A change in the law which occurred after the case was submitted and which was overlooked by the panel.
3. An apparent conflict of another decision of the Court which is not addressed in the opinion.

The filing of a petition in order merely to reargue the case is an abuse of the privilege.

Statement of Counsel

A petition shall contain an introductory statement that, in counsel's judgment, one or more of the situations exists which is described in the "Purpose Section" discussed above. Thereafter, the points to be raised, succintly stated, shall then be listed in the statement. Lacking such a statement, the petition will be returned to counsel without filing.

Form

The 15 page limit allowed by the Rule shall be observed. The Court requires 15 copies of the petition; however, a pro se party who is indigent may file the original only.

Bill of Costs (FRAP 39)

Filing Time

A party to whom costs are allowed, who desires taxation of costs, shall file a bill of costs within 14 days after judgment.

Mandate (FRAP 41)

Issuance Time

The mandate is issued 21 days after judgment. A timely petition for rehearing will stay the issuance. If the petition is denied, the mandate will issue 7 days later. If a stay of mandate is sought, only the original of a motion need be filed.

WILLIAM K. SLATE, II
Clerk

Enclosure

4CCA 28
Rev. 9/17/79

APPENDIX I

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Nos. 79-1644, 79-1653, 79-1654

[Filed Jan. 19, 1981]

DAVID R. JOHNSTON, THE NORTHWESTERN BANK, JAMES R. GILLEY,

Appellees,

vs.

R. A. GILBERT, TRUSTEE, GEORGE W. FULK, THOMAS W. SHELTON, WILLIAM F. SUDDETH, WEBSTER A. COLLINS, HERBERT R. MORRISON, HELEN O. MORRISON, W. O. GREGORY and GLEN A. WILKINSON,

Appellants,

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.,
CONVENIENT SYSTEMS, INC.,
WASHINGTON MILLS COMPANY,
JOHNSTON MILLS EXPORT CO.,
SPINNERS PROCESSING CO.,
WASHINGTON WEAVING CO., and
WASHINGTON MILLS SALES CORP.,

Debtors.

ORDER

Upon consideration of the petition for rehearing, no request for a poll of the court being made on the suggestion for rehearing *en banc*, and with the concurrence of Judge Butzner and Judge Sprouse,

IT IS ORDERED that the petition be, and it is hereby, denied.

FOR THE COURT:

/s/ Clement F. Haynsworth
Chief Judge
Fourth Circuit

January 14, 1981

APPENDIX J

Sections 70(a), 186, 187 and 189 of the Bankruptcy Act, 11 U.S.C. §§ 110(a), 586, 587 and 589 (1976) provide:

§ 110. Title to property

(a) The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this title, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located (1) documents relating to his property; (2) interests in patents, patent rights, copyrights, and trademarks, and in applications therefor: *Provided*, That in case the trustee, within thirty days after appointment and qualification, does not notify the applicant for a patent, copyright, or trade-mark of his election to prosecute the application to allowance or rejection, the bankrupt may apply to the court for an order revesting him with the title thereto, which petition shall be granted unless for cause shown by the trustee the court grants further time to the trustee for making such election; and such applicant may, in any event, at any time petition the court to be revested with such title in case the trustee shall fail to prosecute such application with reasonable diligence; and the court, upon revesting the bankrupt with such title, shall direct the trustee to execute proper instruments of transfer to make the same effective in law and upon the records; (3) powers which he might have exercised for his own benefit, but not those which he might have exercised solely for some other person; (4) property transferred by him in fraud of his creditors; (5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon

and sold under judicial process against him, or otherwise seized, impounded, or sequestered: *Provided*, That rights of action ex delicto for libel, slander, injuries to the person of the bankrupt or of a relative, whether or not resulting in death, seduction, and criminal conversation shall not vest in the trustee unless by the law of the State such rights of action are subject to attachment, execution, garnisment, sequestration, or other judicial process: *And provided further*, That when any bankrupt, who is a natural person, shall have any insurance policy which has a cash surrender value payable to himself, his estate, or personal representatives, he may, within thirty days after the cash surrender value has been ascertained and stated to the trustee by the company issuing the same, pay or secure to the trustee the sum so ascertained and stated, and continue to hold, own, and carry such policy free from the claims of the creditors participating in the distribution of his estate under the bankruptcy proceedings, otherwise the policy shall pass to the trustee as assets; (6) rights of action arising upon contracts, or usury, or the unlawful taking or detention of or injury to his property; (7) contingent remainders, executory devises and limitations, rights of entry for condition broken, rights or possibilities of reverter, and like interest in real property, which were nonassignable prior to bankruptcy and which, within six months thereafter, become assignable interests or estates or give rise to powers in the bankrupt to acquire assignable interests or estates; and (8) property held by an assignee for the benefit of creditors appointed under an assignment which constituted an act of bankruptcy, which property shall, for the purposes of this title, be deemed to be held by the assignee as the agent of the bankrupt and shall be subject to the summary jurisdiction of the court.

All property, wherever located, except insofar as it is property which is held to be exempt, which vests in the

bankrupt within six months after bankruptcy by bequest, devise or inheritance shall vest in the trustee and his successor or successors, if any, upon his or their appointment and qualification, as of the date when it vested in the bankrupt, and shall be free and discharged from any transfer made or suffered by the bankrupt after bankruptcy.

All property, wherever located, except insofar as it is property which is held to be exempt, in which the bankrupt has at the date of bankruptcy an estate or interest by the entirety and which within six months after bankruptcy becomes transferable in whole or in part solely by the bankrupt shall, to the extent it becomes so transferable, vest in the trustee and his successor or successors, if any, upon his or their appointment and qualification, as of the date of bankruptcy.

The title of the trustee shall not be affected by the prior possession of a receiver or other officer of any court.

§ 586. Trustee; title

A trustee, upon his appointment and qualification, shall be vested with such title as a trustee appointed under section 72 of this title would have.

§ 587. Rights, powers, and duties of trustee

Where not inconsistent with the provisions of this chapter, a trustee, upon his appointment and qualification, shall be vested with the same rights, be subject to the same duties, and exercise the same powers as a trustee appointed under section 72 of this title, and, if authorized by the judge, shall have and may exercise such additional rights and powers as a receiver in equity would have if appointed by a court of the United States for the property of the debtor.

§ 589. Operation of business and management of property; reports

A trustee or debtor in possession, upon authorization by the judge, shall operate the business and manage the property of the debtor during such period, limited or indefinite, as the judge may from time to time fix, and during such operation or management shall file reports thereof with the court at such intervals as the court may designate.

* * * *

Rule 10-208 of the Federal Rules of Bankruptcy Procedure provides:

(a) Trustee. A trustee shall (1) file the lists as required by Rule 10-108; (2) unless otherwise ordered, make a report at the meeting provided for in Rule 10-212 which shall include a summary of his operations of the business and management of the property; (3) file with the court within the times fixed by the court, periodic reports and summaries of the operations of the business, and such other information as may be required by the court; (4) investigate the acts, conduct, liabilities and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, and any other matter relevant to the case or to the formulation of a plan; (5) file a report with the court concerning any facts ascertained by him pertaining to fraud, misconduct, mismanagement, and irregularities, and to any cause of action available to the estate; (6) if the court so authorizes, examine the directors and officers of the debtor and any other witnesses concerning the foregoing matters; (7) as soon as practicable, file a statement of his investigations, and cause copies or a summary thereof to be mailed to the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the court may designate; (8) notify creditors and stockholders that they

may submit to him plans or suggestions for the formulation of a plan, within a time fixed by him in such notice; (9) file a plan or report as required by Rule 10-301(c)(1); (10) within 30 days after the date of the order confirming the plan or within such other time as the court may fix, file a report with the court concerning the action taken by him and the progress made in the consummation of the plan and file such further reports as the court may direct until the plan has been consummated; and (11) after consummation of a plan, file an application for a final decree showing that the plan has been consummated, and the names and addresses, if known, of the holders of claims or interests which have not been surrendered or released in accordance with the provisions of the plan and the nature and amounts of such claims or interests, and such other facts as may be necessary to enable the court to pass upon the provisions to be included in the final decree.

* * * *